CITY OF LONDON
Investment Management Company Limited

Frontier Markets Semi-Annual Outlook

February 2025*

Overview

The looming threat of tariffs

Hawkish US trade policy is a headwind for frontier markets (FM), particularly Vietnam. However, stronger fundamentals in most FM suggest a better ability to absorb shocks. In addition, easier Fed policy and an associated softer US dollar should provide some relief for FM central banks. As always, the diverse FM universe will be driven by idiosyncratic factors and domestic political developments, with elections in Argentina, Romania and Georgia scheduled for 2025. Our market preferences are those primed to benefit from global trends such as friend-shoring (Vietnam) and decarbonisation (Kazakhstan and Oman).

Frontier markets (FM) start the year facing multiple headwinds, primarily originating from the US. The Trump administration has been clear that they will address the US' growing trade deficit with trade restrictions and tariffs, with the results of a broad-based review scheduled to be delivered in April. When considering how FM might be impacted by hawkish US trade policy, it is worth considering both the direct and indirect channels. For the former, any FM with a large and growing trade surplus with the US is at risk of tariffs and/or restrictions. Indirectly, tariffs on China could lead to slower Chinese growth, weighing on FM with close trade ties to China. Moreover, heightened tariffs and restrictions would likely result in an unfavourable global backdrop characterised by weaker sentiment, elevated uncertainty and softer commodity prices. Given its role in the global supply chain and large trade surplus with the US, Vietnam is the FM most likely to attract the US' attention.

Trade policies aside, however, there are several reasons why FM could find support in the coming year. For a start, improved fundamentals mean that FM are better positioned to absorb negative shocks. Since the pandemic, most countries have focused on building their FX reserves and narrowing their external and fiscal imbalances, leaving them less vulnerable to changes in investor sentiment (see Chart 1). FM, with the exception of Vietnam, also tend not to be as open to trade (measured by the sum of imports and exports as a share of GDP) as EM.

The global policy rate backdrop may also improve. The US Fed dot plot projections continue to indicate an easing cycle this year. This could pave the way for a softer USD, particularly as it continues to screen as expensive. Meanwhile, US Treasury Secretary Bessent could aim to achieve his policy goals of reducing the budget deficit, boosting GDP growth, and higher oil production through US dollar depreciation. This approach would also boost US competitiveness, reducing the need to use tariffs, which are more disruptive. A softer US dollar would also boost global manufacturing, which has moderated in recent months (see Chart 2). That being said, discussions around possible policies are still ongoing, and the threat of tariffs is likely to continue propping up the US dollar in the near term.

Vietnam has been highlighted as the FM most vulnerable to swings in US trade policy. Vietnam's stock market continued to underperform over the past six months (see Chart 3). The corruption crackdown of 2022, weakness in the property sector and changes in leadership have weighed on sentiment. Vietnam was one of the main beneficiaries of the China Plus One strategy following the trade war during President Trump's first term. As a result, it now has the world's third largest bilateral deficit with the US, meaning it is at risk of tougher US trade restrictions and tariffs, despite the upgrade in the US-Vietnam relationship to a comprehensive strategic partnership in 2023. Nonetheless, there is still scope for a recovery in Vietnamese stocks. The property market is improving, and the Land law should support the recovery. A weaker US dollar would give the State Bank of Vietnam (SBV) space to ease policy, which has been kept tight due to FX pressures, while also boosting global manufacturing. Moreover, despite some uncertainty and tensions in the short term, Vietnam stands to benefit from supply chain readjustments away from China as it boasts relatively stable politics, a skilled labour force and proximity to China. The strength in FDI flows supports this view. Additionally, a growing middle class presents an opportunity for the consumer sector, while the authorities' ambitions to upgrade to EM status suggest a reform-minded government.

Allocation Breakdown

	Chg	-2	-1	0	+1	+2
Argentina	–		■			
Vietnam	–					■
Morocco	–			■		
Iceland	–			■		
Romania	–		■			
Kazakhstan	–				■	
Oman	–				■	
Georgia	–			■		
Pakistan	–			■		

Note: Up/down arrows indicate a positive/negative change in our asset allocation compared to the previous outlook. A dash indicates no change. The table shows the major Frontier Markets.

Source: CLIM

**This publication reflects asset performance up to 31 January, 2025, and macro events and data releases up to 11 February, 2025, unless indicated otherwise.*

In contrast to Vietnam's performance, Argentina was one of the best performing FM over the past six months, as optimism surrounding President Milei's reforms buoyed local stocks. In just over a year, Milei's administration has significantly reduced inflation, narrowed the spread between the official and parallel peso rates and eliminated the budget deficit, all while maintaining steady public approval rates. The turnaround has been impressive, but we are still cautious, given that the next challenge facing the Milei administration is the removal of capital controls. An overvalued peso (the authorities' crawling peg rate has been slower than the pace of monthly inflation) means that any removal of capital controls could be met with a sharp depreciation in the peso, which would push up inflation and undo the hard work of the past year. Insufficient reserves limit the central bank's means of supporting the peso once capital controls are lifted. The difficult decision of when to lift capital controls will likely be made after the midterm elections in October, where Milei's party is widely expected to consolidate power.

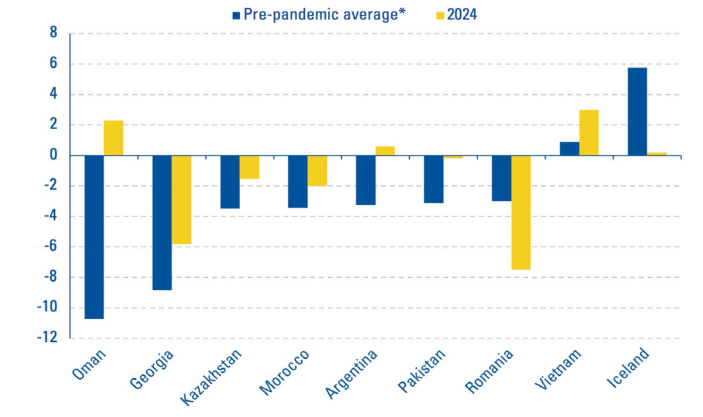
Other upcoming elections in the FM universe are in Romania, where a rerun of the presidential election in May could result in an anti-establishment win following a controversial annulment of last year's elections. Elsewhere, local elections in Georgia may spark fresh protests. Protests have been an ongoing fixture in the country following the introduction of a "foreign agent" law last summer.

Market Strategy: FM equities (MSCI FM 100 Net TR Index) outperformed EM equities (MSCI EM Net TR Index) by 3.4% points over August-January while underperforming DM equities (MSCI World Net TR Index) by 3.1% points. FM performance was propped up by Ukraine and Sri Lanka, with Ukraine the best performing FM after President Trump's election win, which sparked hopes of ending the Russia-Ukraine war. The FM100 12M forward P/E discount to EM is in line with its five-year average, implying neutral valuations.

While US policy is likely to be volatile in the coming months, we favour markets with exposure to strategic themes such as decarbonisation and friend-shoring. As the world seeks to move away from fossil fuels while expanding energy-hungry artificial intelligence (AI) models, markets with alternative energy sources stand to gain. Kazakhstan is the largest producer of natural uranium (Kazatamprom is 25% of the country's MSCI Index), which is becoming an important alternative energy source. Oman may also benefit from growth in alternative energy if the country succeeds in producing and exporting renewable hydrogen as part of its Vision 2040 and broader economic diversification reforms. Meanwhile, as outlined above, Vietnam remains an attractive friend-shoring partner given its relatively stable politics, border with China and skilled workforce. Therefore, our preferred markets are Vietnam, Kazakhstan and Oman. We maintain our underweights in Argentina and Romania as the former faces the daunting task of lifting capital controls, and the latter's outlook is weighed down by political uncertainty. We make no changes to our allocation this publication.

Yasemin Engin
February 11, 2025

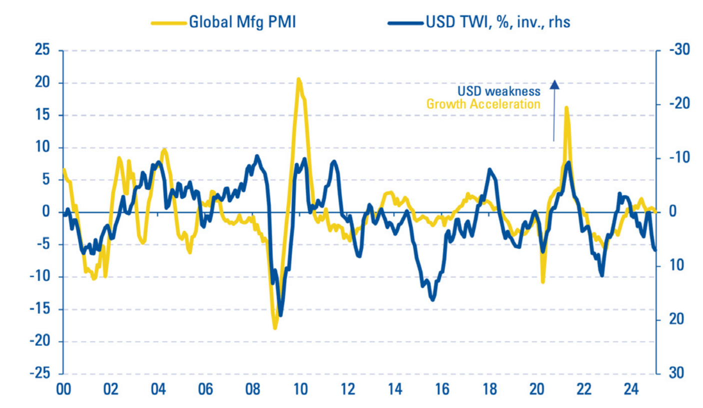
Chart 1: Current Account Balance, % of GDP



**Average over 2015-19.*

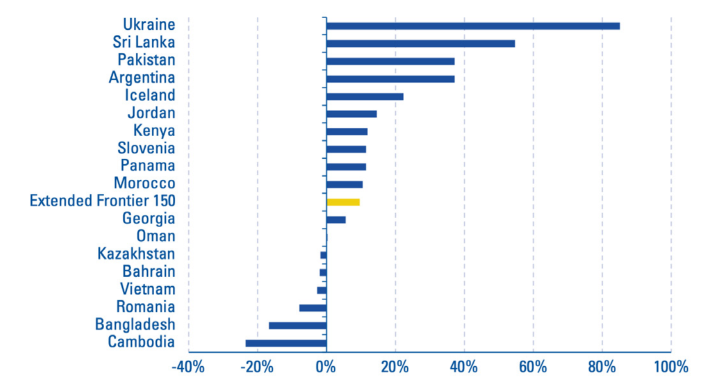
Source: IMF

Chart 2: Global Manufacturing PMI vs USD TWI, yoy



Source: Bloomberg

Chart 3: S&P Extended Frontier 150 Net TR USD %, Aug 24 - Jan 25



Source: S&P

Argentina

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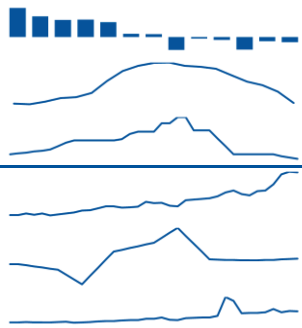

	Latest	
GDP, % yoy	-2.1	Q3
CPI, % yoy	117.8	Dec
Policy rate, %	29.00	Dec
MSCI Argentina*	79.8%	Jan
EPS, % yoy**	32.2	Jan
Trailing P/E	14.6	Jan

**US$ total return relative to MSCI FM 100. Latest is six-month return.*
***12-month moving average*

Source: Bloomberg

- Argentina underwent an impressive economic transformation during the first year of Milei's presidency, with inflation falling sharply and the budget balance tipped into a surplus for the full year in 2024. In addition, early signs suggest that the worst of the slowdown in economic activity may be over.
- Nonetheless, we still have concerns over the outlook. Lifting capital controls, a likely requirement for further IMF funding, will be challenging given insufficient reserves. The peso is overvalued as the pace of the crawling peg has been slower than inflation, meaning floating the peso could lead to a sharp depreciation and, thereby, a spike in inflation. As such, adjustments are unlikely until after October's mid-term election, where Milei's party is expected to consolidate power.
- The success so far of the Milei government is positive and has reduced some downside risks. However, lifting capital controls will likely be the biggest challenge. As such, we keep our *underweight.*

Vietnam

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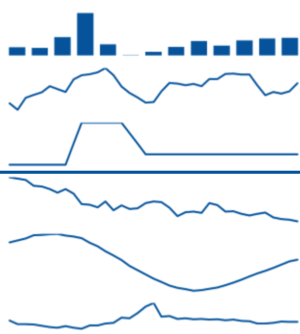

	Latest	
GDP, % yoy	7.6	Q4
CPI, % yoy	3.6	Jan
Policy rate, %	4.50	Jan
MSCI Vietnam*	-7.0%	Jan
EPS, % yoy**	12.5	Jan
Trailing P/E	18.3	Jan

**US$ total return relative to MSCI FM 100. Latest is six-month return.*
***12-month moving average*

Source: Bloomberg

- The biggest headwind facing Vietnam is a hawkish US trade policy. Since the last Trump presidency, Vietnam's bilateral trade surplus with the US has grown and become more integrated into global supply chains. US policy that focuses on rules of origin for Vietnam's exports would be particularly damaging. Meanwhile, FX pressures have constrained the State Bank of Vietnam's ability to support the economy.
- Over the medium term, however, Vietnam's proximity to China, stable politics, and skilled labour force allow it to benefit from friend-shoring. Indeed, FDI flows remained robust in 2024. In the property sector, the Land law should aid the recovery.
- Vietnam's stock market continued to underperform over the last six months, further cheapening valuations. A challenging short-term aside, we think that Vietnamese stocks can recover on the back of an improvement in the property sector and strong medium-term fundamentals. We stay *overweight.*

Morocco

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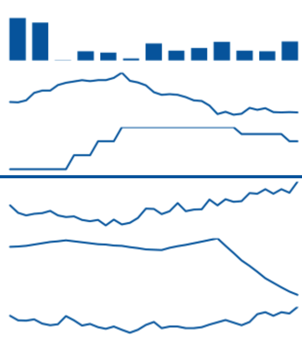

	Latest	
GDP, % yoy	4.3	Q3
CPI, % yoy	0.7	Dec
Policy rate, %	2.50	Dec
MSCI Morocco*	9.5%	Jan
EPS, % yoy**	-144.6	Jan
Trailing P/E	24.7	Jan

**US$ total return relative to MSCI FM 100. Latest is six-month return.*
***12-month moving average*

Source: Bloomberg

- Morocco's economic outlook is relatively stable as it appears less vulnerable to trade war risks, albeit its close ties to Europe means that it still has some exposure. Inflation is contained, allowing the Bank Al-Maghrib to continue to ease rates. The current account and fiscal deficit are in check relative to other FM.
- Following six years of drought, there has been a much-welcome improvement in weather conditions. However, Morocco's large agricultural sector and increasing freshwater shortage make it sensitive to climate events.
- Morocco's stock market screens expensive, and with the country still grappling with a years-long drought, we remain *neutral.*

Iceland

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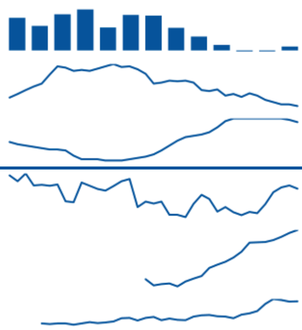

	3Y history	Latest	
GDP, % yoy		1.0	Q3
CPI, % yoy		4.6	Jan
Policy rate, %		8.50	Jan
MSCI Iceland*		16.2%	Jan
EPS, % yoy**		14.9	Jan
Trailing P/E		38.2	Jan

**US$ total return relative to MSCI FM 100. Latest is six-month return.*
***12-month moving average*

Source: Bloomberg

- Iceland's economy is set for a rebound on the back of easier monetary policy and an improvement in exports. The fiscal stance is projected to remain tight, despite disaster-related spending, helping contain inflationary pressures. Disruptive volcanic activity and a poor fishing season are risks to the outlook.
- Over the medium term, migrant inflows should help with labour market pressures, while the growing pharmaceutical and biotechnology sectors should boost exports. The IMF noted in July that "financial institutions remain resilient".
- Valuations for the MSCI Iceland Index appear expensive compared to the MSCI FM100 on a 12M forward P/E basis, albeit the data has a short history. As such, we are *neutral.*

Romania

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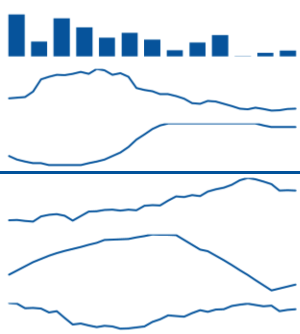

	3Y history	Latest	
GDP, % yoy		1.2	Q3
CPI, % yoy		5.1	Dec
Policy rate, %		6.50	Dec
MSCI Romania*		-14.7%	Jan
EPS, % yoy**		-10.5	Jan
Trailing P/E		7.8	Jan

**US$ total return relative to MSCI FM 100. Latest is six-month return.*
***12-month moving average*

Source: Bloomberg

- Romania's outlook is dampened by its persistent twin deficit problem and political uncertainty. Following a controversial annulment of the first round of the presidential election, where a far-right candidate was projected to win, new elections have been set for May. Mainstream party candidates are behind in the polling, implying more political turmoil.
- Political upheavals are delaying much-needed fiscal consolidation, with the fiscal deficit projected to stay wide. Romania is under the European Commission's Excessive Deficit Procedure as it has consistently breached the 3% deficit target. The current account deficit will stay wide as easier fiscal policy leaks into imports.
- Despite underperforming over the past six months, MSCI Romania continues to screen expensive compared to FM100 on a 12M forward P/E basis. The lack of resolve to fix the country's twin deficit problem and lingering political uncertainty keeps us *underweight.*

Kazakhstan

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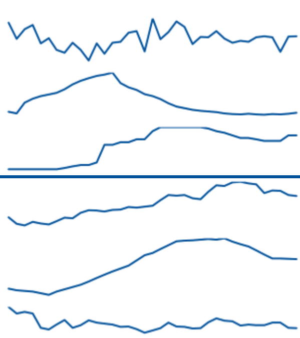

	3Y history	Latest	
IP, % yoy		3.8	Dec
CPI, % yoy		8.9	Jan
Policy rate, %		15.25	Jan
MSCI Kazakhstan*		-19.7%	Jan
EPS, % yoy**		16.4	Jan
Trailing P/E		7.4	Jan

**US$ total return relative to MSCI FM 100. Latest is six-month return.*
***12-month moving average*

Source: Bloomberg

- The Kazakh stock market was one of the weakest FM over the past six months as a short seller report dragged on Kaspi, a fintech company. Tenge weakness and inflationary pressures suggest the National Bank of Kazakhstan will maintain a tight monetary stance.
- Kazakhstan's ample uranium reserves mean it should benefit from the decarbonisation trend. Expansionary fiscal policy has supported non-oil activity. Debt sustainability is not yet an issue but the IMF urges expanding non-oil revenue and reducing reliance on transfers from the sovereign wealth fund.
- Kazakhstan's stock market cheapened on a 12M forward P/E relative basis. On Kaspi, strong forward earnings should help sentiment. As a way of gaining exposure to the decarbonisation shift (uranium), we are *overweight.* We add to our allocation in response to the recent pullback in uranium prices.

Oman

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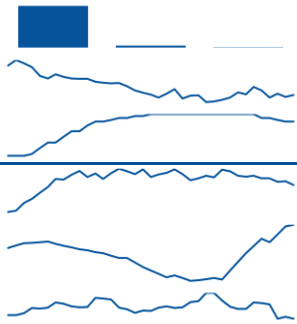

	3Y history	Latest	
GDP, % yoy*		1.0	2024
CPI, % yoy		0.7	Dec
Policy rate, %		5.00	Dec
MSCI Oman**		-8.3%	Jan
EPS, % yoy***		20.1	Jan
Trailing P/E		9.0	Jan

**Annual GDP series for three years.*
***US$ total return relative to MSCI FM 100. Latest is six-month return.*
****12-month moving average.*

Source: Bloomberg

- Oman's relative political stability within the region and its improved external and fiscal positions provide a solid backdrop for the market. The breakeven oil price for both balances has fallen over the years as Oman has deleveraged its debt, reducing the Sultanate's sensitivity to oil prices. While both balances are expected to tip into a small deficit this year, they are healthy.
- Vision 2040 reforms are underway, including a personal income tax. Other areas are the labour market and reducing state involvement. Oman's renewable energy resources and ample land allow it to produce low-carbon (green) hydrogen and thus benefit from the shift to decarbonisation. The IEA estimates that Oman could be the world's sixth largest hydrogen exporter by 2030.
- Relative valuations for MSCI Oman have improved as its 12M forward P/E premium to FM100 is in line with its five-year average. Its stable economic backdrop and potential for structural reforms make the market attractive. We remain *overweight*.

Georgia

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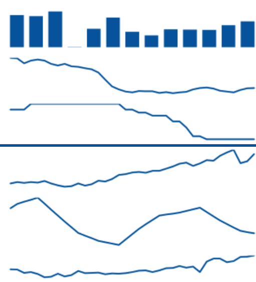

	3Y history	Latest	
GDP, % yoy		11.5	Q3
CPI, % yoy		2.0	Jan
Policy rate, %		8.00	Jan
S&P Ext. Frontier 150 Georgia*		-4.1%	Jan
EPS, % yoy**		28.3	Jan
Trailing P/E**		6.1	Jan

**US$ total return relative to S&P Extended Frontier 150. Latest is six-month return.*
***Average for Georgia Capital, Bank of Georgia and TBC Bank.*
EPS is the 12-month moving average.

Source: Bloomberg

- Domestic politics is set to dominate the outlook, with risks of escalation. October's parliamentary election, which resulted in a victory for the ruling Georgian Dream party, sparked fresh protests. EU accession talks and funding have been suspended. Beyond the short-term disruptions, 70-80% of the population want EU membership and a path to the EU is enshrined in the constitution.
- Political unrest has yet to translate into weaker economic activity; however, dollarisation has increased. Moreover, efforts by the National Bank of Georgia to support the lari has come at the expense of FX reserves.
- The possibility of EU accession and the reforms associated with it would be a positive catalyst for Georgia, however the precarious political situation keeps us *neutral*.

Pakistan

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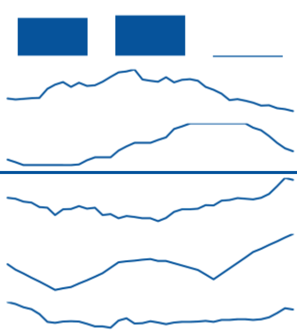

	3Y history	Latest	
GDP, % yoy*		-0.2	2023
CPI, % yoy		2.4	Jan
Policy rate, %		12.00	Jan
MSCI Pakistan**		41.4%	Jan
EPS, % yoy***		17.5	Jan
Trailing P/E		5.6	Jan

**Annual GDP series for three years.*
***US$ total return relative to MSCI FM 100. Latest is six-month return.*
****12-month moving average.*

Source: Bloomberg

- Pakistan's economic activity is improving, while the IMF's approval of a three-year $7 billion Extended Fund Facility program should help with external funding needs. Inflation has fallen sharply from double digits, paving the way for more monetary easing, and the current account balance has tipped into a small surplus.
- The outlook still faces risks as the government has to meet its IMF programme requirements, with fiscal goals for FY25 likely to prove ambitious as they require politically sensitive tax hikes and cuts to spending. Meanwhile, Pakistan's close ties to China could become an issue with the new Trump administration.
- Pakistan's stock market rebounded in the past six months over IMF programme optimism. As such, MSCI Pakistan's 12M forward P/E discount to FM100 has narrowed sharply. The fragile political backdrop and IMF programme conditions means that we are *neutral*.

KEY ECONOMIC AND FINANCIAL INDICATORS

	Frontier Market	Annual GDP Growth YoY	Quarterly GDP Growth QoQ*	Industrial Production Growth YoY	Consumer Price Index YoY	Trade Balance	Current Account	Foreign Reserves 2024 Latest	Foreign Reserves 2023 Year Ago	Currency vs $ 2025 Latest	Currency vs $ 2024 Year ago	Sovereign Rating S&P	Budget Balance % of GDP 2025F**	Short-Term Interest Rates	% S&P Frontier 150 Index***	Stock Market Index (S&P Frontier 150 Index) US$	Change since 12/31/24 US$	Change since 12/31/24 Local	Trailing P/E	6 month Currency vs $ +/-
		Macroeconomic Data													Market Performance					Forecast (Bloomberg)†
		% change on year ago				Latest 12 months														
		%	%	%	%	$ Bns	$ Bns	$ Bns	$ Bns					%	Jan. 31, 2025	Jan. 31, 2025	%	%		
Overweight	VIETNAM	7.6	n.a.	0.6	3.6	22.5	23.9	82.3	87.6	25388.0	24424.0	BB+	-3.5	3.5	14.4	452.3	0.5	-1.1	17.3	-
Overweight	KAZAKHSTAN	4.1	n.a.	3.8	8.9	22.3	-4.4	19.8	14.2	509.5	447.6	BBB-	-2.8	n.a.	11.1	343.4	2.3	11.6	0.1	n.a.
Overweight	OMAN	1.0	n.a.	n.a.	0.7	n.a.	2.6	16.5	15.6	0.4	0.4	BBB-	-0.5	4.8	5.4	4391.6	1.2	1.1	10.1	uc
Neutral	BAHRAIN	2.1	n.a.	n.a.	0.5	4.5	2.7	4.1	4.4	0.4	0.4	B+	-5.1	5.2	1.4	6712.8	1.5	1.5	10.4	uc
Neutral	BANGLADESH	6.0	n.a.	n.a.	9.9	-26.9	3.1	14.8	15.6	121.9	109.7	B+	n.a.	9.2	0.2	820.8	-12.2	-10.3	14.1	n.a.
Neutral	CAMBODIA	5.3	n.a.	n.a.	3.1	n.a.	1.2	17.1	15.5	4016.0	4075.0	NR	n.a.	1.5	0.6	640.6	-1.3	-3.3	n.a.	n.a.
Neutral	GEORGIA	11.5	n.a.	n.a.	2.0	0.0	-1.5	3.3	4.4	2.8	2.6	BB	-2.5	8.5	5.2	3396.5	2.5	7.7	22.0	n.a.
Neutral	ICELAND	1.0	-4.4	n.a.	4.6	-27.0	0.4	5.6	5.0	141.9	137.6	A+	n.a.	8.0	9.5	884.9	0.4	1.9	129.8	n.a.
Neutral	MOROCCO	4.3	n.a.	9.2	0.7	-29.3	-2.0	33.1	32.7	10.0	10.0	BB+	-3.8	3.0	14.1	1551.7	13.9	12.8	48.8	n.a.
Neutral	PAKISTAN	-0.2	n.a.	-3.8	2.4	-24.5	n.a.	12.9	9.3	278.9	278.9	CCC+	-6.5	11.6	3.3	1417.5	-5.9	-5.7	5.6	n.a.
Neutral	PANAMA	9.0	n.a.	n.a.	-0.2	0.2	-1.3	6.3	6.1	1.0	1.0	BBB-	-4.3	1.5	4.6	6899.7	6.1	6.1	6.2	uc
Underweight	UKRAINE	2.0	0.8	-0.3	12.0	-14.3	-13.4	40.4	37.8	41.6	38.0	SD	-17.7	8.6	0.5	224.6	3.9	5.4	0.1	n.a.
Underweight	ARGENTINA	-2.1	15.6	-13.3	117.8	18.9	2.5	29.4	25.1	1053.4	830.2	CCC	0.0	29.1	16.1	10840.6	7.7	21.4	9.1	-
Underweight	KENYA	4.0	4.1	n.a.	3.3	-11.7	n.a.	8.2	7.0	129.6	158.3	B-	-4.7	10.5	1.6	2273.0	1.0	0.9	4.3	-
Underweight	ROMANIA	1.2	0.1	-1.3	5.1	-36.0	-30.4	61.1	62.5	4.8	4.6	BBB-	-7.0	5.8	12.1	4126.6	2.1	1.7	8.1	-

*Note: All data shown are as at February 10, 2025 unless otherwise stated. S&P credit rating shown is long-term foreign currency rating. * % change in GDP on previous quarter, annual rate.*
***Any forecasts are based on Bloomberg consensus forecasts, where available, and assumptions. Actual results may vary from any such statements or forecasts. Past performance is no guarantee of future results.*
****S&P Extended Frontier 150 Net Total Return Index. Data are the latest available, but in certain cases relate to periods more than one year ago.*

Source: Bloomberg, CLIM

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